

Consolidated Financial Statements and Report of
Independent Certified Public Accountants
Philip Services Corporation and Subsidiaries
December 31, 2004

PHILIP SERVICES CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2004

Table of Contents

	<u>Page</u>
Report of Independent Certified Public Accountants	2
Consolidated Balance Sheet	3
Consolidated Statement of Earnings	4
Consolidated Statement of Stockholders' Equity	5
Consolidated Statement of Cash Flows	6
Notes to Consolidated Financial Statements	7 – 22

Report of Independent Certified Public Accountants

The Board of Directors
Philip Services Corporation:

We have audited the accompanying consolidated balance sheet of Philip Services Corporation and subsidiaries as of December 31, 2004, and the related consolidated statements of earnings, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Philip Services Corporation and subsidiaries as of December 31, 2004, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information included in Note 17 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Grant Thornton LLP

Houston, Texas
March 17, 2005

PHILIP SERVICES CORPORATION
CONSOLIDATED BALANCE SHEET

December 31, 2004

(In Thousands)

ASSETS

Current assets	
Cash and cash equivalents (Note 2)	\$ 59,722
Accounts receivable (net of allowance for doubtful accounts of \$7,347) (Note 4)	149,616
Inventory	53,915
Other current assets (Note 5)	27,304
Total current assets	<u>290,557</u>
Property, plant and equipment (Note 6)	176,393
Deferred income taxes (Note 13)	29,651
Other assets (Note 7)	48,341
Total assets	<u><u>\$ 544,942</u></u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities	
Accounts payable	\$ 36,322
Accrued liabilities (Note 8)	85,957
Current maturities of long-term debt (Note 9)	3,891
Total current liabilities	<u>126,170</u>
Long-term debt, less current portion (Note 9)	22,681
Other liabilities (Note 10)	50,251
Commitments and contingencies (Note 14 and 15)	
Stockholders' equity	345,840
Total liabilities and stockholders' equity	<u><u>\$ 544,942</u></u>

The accompanying notes are an integral part
of these consolidated financial statements.

PHILIP SERVICES CORPORATION
CONSOLIDATED STATEMENT OF EARNINGS

Year ended December 31, 2004
(In Thousands)

Revenue	\$ 1,147,963
Operating expenses	960,119
Selling, general and administrative costs	80,764
Depreciation and amortization	34,438
Income from operations	<u>72,642</u>
Interest expense	12,420
Other income, net	7,470
Income from continuing operations before income taxes	<u>67,692</u>
Benefit for income taxes (Note 13)	20,678
Income from continuing operations	<u>88,370</u>
Income from discontinued operations, net of taxes (Note 3)	2,740
Net income	<u><u>\$ 91,110</u></u>

The accompanying notes are an integral part
of these consolidated financial statements.

PHILIP SERVICES CORPORATION
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
Year ended December 31, 2004
(In Thousands)

	Common Stock <u>At Par Value</u>	Additional <u>Paid-In-Capital</u>	Retained <u>Earnings</u>	Accumulated Other Comprehensive <u>Income</u>	Total Stockholders' <u>Equity</u>
Balance, December 31, 2003	\$ 100	\$ 162,467	\$ 83,660	\$ 5,898	\$ 252,125
Comprehensive income:					
Net income			91,110		
Foreign currency translation adjustments				2,605	
Total comprehensive income					93,715
Balance, December 31, 2004 (Note 12)	\$ 100	\$ 162,467	\$ 174,770	\$ 8,503	\$ 345,840

The accompanying notes are an integral part
of these consolidated financial statements.

PHILIP SERVICES CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31, 2004
(In Thousands)

OPERATING ACTIVITIES:

Income from continuing operations	\$ 88,370
Items included in income not affecting cash:	
Depreciation and amortization	34,438
Accrued but unpaid interest	569
Deferred income taxes	(23,670)
Loss on sale of assets	274
Cash flow before changes in assets and liabilities	99,981
Changes in assets and liabilities (Note 11)	62,714
Cash provided by continuing operating activities	162,695
Cash used in discontinued operating activities	(4,085)
Cash provided by operating activities	158,610

INVESTING ACTIVITIES:

Purchase of property, plant and equipment	(39,540)
Proceeds from sale of assets	6,449
Cash used in continuing investing activities	(33,091)
Cash provided by investing activities of discontinued operations	28,714
Cash used in investing activities	(4,377)

FINANCING ACTIVITIES:

Proceeds from fixed and variable rate notes and capital leases	5,208
Principal payment on short and long-term debt	(153,000)
Principal payments on fixed and variable rate notes and capital leases	(5,422)
Cash used in financing activities	(153,214)
Net change in cash for the year	1,019
Effect of exchange rate on cash	821
Cash and equivalents, beginning of year	57,882
Cash and equivalents, end of year	\$ 59,722

The accompanying notes are an integral part of these consolidated financial statements.

PHILIP SERVICES CORPORATION

Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

(1) Organization and Basis of Presentation

These consolidated financial statements contain information relating to Philip Services Corporation ("PSC"), a Delaware corporation, and its subsidiaries (collectively, the "Company"), which have been prepared by management. The Company is an industrial services and metals services company that provides industrial outsourcing, environmental services and metals services to major industry sectors throughout North America. The consolidated financial statements of the Company have been prepared in U.S. dollars using accounting principles generally accepted in the United States of America.

(2) Significant Accounting Policies

Use of estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management of the Company to make estimates and assumptions that affect reported amounts of assets, liabilities, income and expenses and disclosures of contingencies. Actual results could differ from the estimates and judgments made in preparing these consolidated financial statements. Significant items subject to such estimates and assumptions include the carrying value of property, plant and equipment, inventories, deferred income tax assets, environmental liabilities, insurance claims, and accrued closure costs.

Principles of consolidation

These consolidated financial statements include the accounts of the Company and all of its majority owned subsidiaries. All material intercompany transactions and balances have been eliminated on consolidation.

Revenue recognition

Revenue from industrial services is recorded as the services are performed, using the percentage-of-completion basis for fixed rate contracts and as-the-related-service-is-provided basis for time and material contracts. Revenue from by-product recovery operations is recognized along with the related costs of treatment, disposal and transportation at the time of performance of services. Revenue from the direct sale of recovered commodities and steel products or for contracts where the Company brokers materials between two parties, takes title to the product and assumes the risks and rewards of ownership is recognized at the time of customer acceptance. If the Company is acting as an agent in those transactions, then only the commission on the transaction is recorded.

The Company uses the percentage-of-completion basis to account for its fixed price contracts. Under this method, revenue is recognized as work progresses in the ratio that costs bear to estimated total costs for each contract. Contract costs include all direct material and labor costs and those indirect costs related to contract performance. Selling, general and administrative costs are charged to expense as incurred. Provisions for estimated losses on incomplete contracts are recorded in the period in which such losses are determined. Changes in estimates or differences in the actual cost to complete the contract could result in recognition of differences in earnings.

Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and term deposits in money market instruments with original maturity dates of less than three months from the date they are acquired. The Company maintains cash balances in foreign bank accounts. All of the foreign accounts are in Canada and the amount in those accounts as of December 31, 2004 was \$4,854. At December 31, 2004, the Company had cash balances in excess of the Federal Deposit Insurance Corporation maximum of one hundred thousand dollars. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements
December 31, 2004
(Amounts in Thousands)

Accounts receivable, net

The Company's receivables are recorded when billed or accrued and represent claims against third parties that will be settled in cash. The carrying value of the Company's receivables, net of allowance for doubtful accounts, represents their estimated net realizable value. The Company estimates its allowance for doubtful accounts based on historical trends, type of customer, the age of the outstanding receivables and existing economic conditions. If events or changes in circumstances indicate that specific receivable balances may be impaired, further consideration is given to the collectibility of those balances and the allowance is adjusted accordingly. Past-due receivables balances are written-off against the allowance when the Company's internal collection efforts have been unsuccessful in collecting the amount due.

Inventory

Inventory is recorded at the lower of average purchased cost or market and is primarily comprised of processed scrap metal held for resale.

Property, plant and equipment

Additions to property, plant and equipment are recorded at cost. Property, plant and equipment are depreciated over their estimated useful lives generally on the following basis: buildings 20 to 40 years straight-line; equipment 3 to 20 years straight-line. Landfill site and improvements thereto are recorded at cost and amortized over the life of the landfill site based on the estimated landfill capacity utilized during the year. Operating costs associated with landfill site are charged to operations as incurred. Assets under development include the direct cost of land, buildings and equipment acquired for future use together with engineering, legal and other costs incurred before the assets are brought into operation.

Under the provisions of SOP 98-1, the Company capitalizes certain costs associated with developing or obtaining internal-use software. These costs include external direct costs of materials and services used in developing or obtaining the software and payroll and payroll-related costs for employees directly associated with the software development project. At December 31, 2004, the Company has capitalized costs in the amount of \$10,266, which was fully depreciated.

The Company leases certain property, plant and equipment in the ordinary course of its business. The leases have varying terms. Some may include renewal or purchase options, escalation clauses, restrictions, penalties or other obligations that are considered in determining minimum lease payments. The leases are classified as either capital leases or operating leases, as appropriate in accordance with SFAS No. 13, "Accounting for Leases."

The Company includes as part of the cost of its property, plant and equipment, all financing costs incurred prior to the asset becoming available for operation. No significant amounts of interest were capitalized during the period presented.

Impairment of long lived assets

The Company reviews long-lived assets, including property, plant and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Management will determine whether there has been a permanent impairment on such assets held for use in the business by comparing anticipated undiscounted future cash flows from operating activities involving the asset to the carrying value of the asset. The amount of any resulting impairment will be calculated using the present value of the same cash flows. Long-lived assets to be disposed of are valued at the lower of carrying amount or net realizable

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements
December 31, 2004
(Amounts in Thousands)

value. There have been no events or changes in circumstances that have changed management's determination regarding a permanent impairment at December 31, 2004.

Restricted investments

Restricted investments, which have been classified in other assets, are carried at cost, which approximates fair market value.

Environmental liability

The Company accrues environmental remediation costs associated with identified sites where an assessment has indicated that cleanup costs are probable and can be reasonably estimated. Such accruals are based on currently available information, estimated timing of remedial actions, existing technology and enacted laws and regulations. The liability for environmental and closure costs is included in the consolidated balance sheet under accrued liabilities and other liabilities. Costs to dispose of waste materials located at the Company's industrial services facilities are included in accrued liabilities. The Company is accounting for its environmental remediation costs in accordance with AICPA Statement of Position 96-1, "Environmental Remediation Liabilities."

Where the Company believes that both the amount of a particular environmental remediation liability and the timing of the payments are reliably determinable, the liability is measured on a present value basis, using a credit-adjusted, risk-free rate of 7.75%, which represents the prime interest rate plus 2%, coupled with an inflation rate of 2.25%. As of December 31, 2004, the total environmental remediation liabilities recorded are \$46,753, of which \$18,013 is discounted to present value. The portion of the recorded environmental remediation liabilities that are not subject to inflation or discounting as the amounts and timing of payments are not readily determinable amounts to \$28,740.

Financial instruments

The Company's accounts receivable, restricted investments, accounts payable and long-term debt constitute financial instruments. The Company's accounts receivable and accounts payable approximated their fair value as at December 31, 2004. The fair value of the Company's long-term debt is discussed in Note 9 to the consolidated financial statements. Concentration of credit risk in accounts receivable is limited, due to the large number of customers the Company services throughout North America. The Company performs ongoing credit evaluations of its customers, but does not require collateral to support customer accounts receivable. The Company establishes an allowance for doubtful accounts based on the credit risk applicable to particular customers and historical and other information.

Income taxes

Deferred income taxes are determined based on the difference between the financial reporting and tax bases of assets and liabilities. The deferred income tax provision represents the change during the reporting period in the deferred tax assets and liabilities, net of the effect of discontinued operations and the cumulative effect of a change in accounting principle. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in years in which these temporary differences are expected to be recovered or settled. Deferred tax assets include tax loss and credit carryforwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

Foreign currency translation and transactions

The functional currency of the Company's foreign subsidiaries is its respective local currency. The assets and liabilities denominated in a foreign currency for foreign operations are translated at exchange rates in effect at the balance sheet date. Revenues and expenses are translated using an average exchange rate during the period. The resulting gains and losses are reflected in the accumulated other comprehensive income in stockholders' equity. The transaction gain of \$1,065 is reflected as a component of other income.

Employee Benefit Plans

The Company's 401(k) Plan ("Plan") covers employees following a one month waiting period after hire. Through December 31, 2004 eligible employees may contribute up to 20% of their annual compensation. All employee contributions are subject to annual contribution limitations established by the IRS. Under the Plan, the Company matches in cash, 50% of employee contributions up to a maximum match of three thousand dollars after one year of service. The company contributions vest after two years of service. Charges to operations for the defined contribution plan were \$2,828 during 2004.

(3) Discontinued Operations

For the year ended December 31, 2004 the Company recognized a gain on discontinued operations of \$2,740. The gain on discontinued operations, net of tax, comprises the following:

- In June 2004, all assets and liabilities of the Company's Canadian Analytical Division were sold to Callisto Capital L.P. for proceeds of \$28,714. A gain on the divestiture was recorded in the amount of \$6,824. As such, the Company recorded the results of operations of the Canadian Analytical Division as discontinued on the Consolidated Statement of Earnings for the year ended December 31, 2004. The Company's Canadian Analytical Division generated revenue of approximately \$15,161 and after-tax income from discontinued operations, including the aforementioned gain recorded in the second quarter of 2004 on the sale of the Canadian Analytical Division's assets and liabilities, of \$6,316 in the year ended December 31, 2004.
- Residual costs related to the Company's former Project Services Division, which was sold in 2003, were \$3,576 in the year ended December 31, 2004.

	YEAR ENDED DECEMBER 31, 2004
Revenue	\$ 15,161
Income before income taxes	2,719
Income tax benefit	21
Net income	\$ 2,740

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements
December 31, 2004
(Amounts in Thousands)

(4) Accounts Receivable

	DECEMBER 31, 2004
Billed trade receivables	\$ 139,830
Accrued revenue	17,133
Total accounts receivable	156,963
Allowance for doubtful accounts	(7,347)
Net accounts receivable	\$ 149,616

(5) Other Current Assets

	DECEMBER 31, 2004
Costs and estimated earnings in excess of billings	\$ 6,509
Non-trade receivables	3,112
Consumable supplies	5,830
Other	11,853
	\$ 27,304

(6) Property, Plant and Equipment

	DECEMBER 31, 2004		
	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 39,917	\$ (1,498)	\$ 38,419
Landfill site	26,362	(17,169)	9,193
Buildings	54,315	(22,418)	31,897
Equipment	200,109	(118,180)	81,929
Assets under development	14,955	-	14,955
	\$ 335,658	\$ (159,265)	\$ 176,393

(7) Other Assets

	DECEMBER 31, 2004
Restricted investments (a)	\$ 33,226
Other	15,115
	\$ 48,341

(a) The majority of the Company's restricted investments are controlled by the Company's wholly owned insurance subsidiary and totaled approximately \$33,226 at December 31, 2004. The insurance subsidiary's restricted investments have been pledged as security for the Company's insurance liabilities. The restricted investments are held primarily in US and foreign government and commercial debt instruments rated AA or better by Moody's and Standard & Poors. At December 31, 2004, restricted investments controlled by the Company's wholly owned insurance subsidiary comprise \$20,687 of cash and cash equivalents and \$12,539

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

in bonds with maturities from December 2005 through December 2014. The Company classifies these investments as investments held to maturity.

(8) Accrued Liabilities

Accrued liabilities consist of the following:

	DECEMBER 31, 2004
Insurance claims outstanding (a)	\$ 47,003
Accrued employee compensation and benefit costs	10,796
Accrued purchases	3,982
Accrued interest	260
Accrued property and commodity taxes	4,662
Accrued waste material disposal costs	2,973
Accrued closure, severance and restructuring costs	1,443
Accrued environmental costs (Note 15)	5,031
Income taxes payable	2,522
Accrued other	7,285
	<u>\$ 85,957</u>

(a) The Company determines its insurance claims liability using actuarial principles on an undiscounted basis. The Company retains liability for (i) workers' compensation claims of up to \$1,000 for any one occurrence; (ii) auto and general liability claims of up to \$1,000 for any one occurrence; and (iii) certain property claims of up to \$2,000 for any one occurrence. To the extent that any insurance carrier is unable to meet its obligations under existing insurance policies, the Company could be liable for the defaulted amount. From time to time, other retention amounts apply because claims arise under policies of subsidiary, acquired or predecessor companies.

Various insurance policies prior to June 1999, including workers' compensation policies, were placed by Philip Services Corp., an Ontario corporation and PSC's predecessor corporation, with Reliance Insurance Company and/or its former subsidiary companies ("Reliance Insurance"). On October 3, 2001, the Insurance Commissioner of Pennsylvania placed Reliance Insurance into liquidation. State guaranty associations have been ordered to assume the insured obligations of Reliance Insurance, subject to statutory limitations. Until such plans are finalized by the various state associations, there is a risk that the Company could be liable for some portion of the Company's claims that are contractually covered by Reliance. Cash and letters of credit on deposit with Reliance Insurance are specifically dedicated to the Company's retained liability up to \$500 per occurrence and should not be pooled or otherwise used to settle Reliance Insurance liabilities. The Company has recorded a reserve to reflect the potential exposure pending further clarification of the liabilities by the courts. The reserve balance was \$3,700 at December 31, 2004.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements
December 31, 2004
(Amounts in Thousands)

(9) Long-Term Debt

	DECEMBER 31, 2004
Term Loan Agreement (a)	\$ -
Payment-in-kind promissory notes (d)	15,860
Loans collateralized by certain assets having a net book value of \$7,522 bearing interest at a weighted average fixed rate of 5.6% maturing at various dates up to 2020	7,736
Obligations under capital leases on equipment bearing interest at rates varying from 5% to 9.6% maturing at various dates to 2011	2,976
	26,572
Less current maturities of long-term debt	3,891
	\$ 22,681

(a) Term Note Agreement

As of December 31, 2003, the Company entered into a term loan agreement (the "Term Loan"). The Term Loan provided term debt borrowings of \$150,000. The Term Loan had an annual fixed interest rate of 3.6% and was to mature on December 31, 2010. Interest payments on the term debt were due monthly in arrears. The Term Loan was collateralized by security interests in all of the assets of the Company as well as its direct and indirect wholly owned subsidiaries. The Term Loan contained certain restrictive covenant provisions, including limitations on the incurrence of indebtedness, the sale of assets, the incurrence of liens and the making of specified investments. As of December 31, 2004, the Company has repaid the full balance of the Term Loan.

(b) Letter of Credit Agreement

As of December 31, 2003, the Company entered into a letter of credit agreement ("LOC Agreement") with Fleet Capital Corporation and Fleet National Bank to meet its outstanding letter of credit obligations upon emergence from the Chapter 11 reorganization. The size of this LOC agreement was \$90,000 (subsequently amended to \$100,000 on February 26, 2004) and was collateralized by cash. Letters of credit under this LOC agreement bore an annual fee of 2.0% and were to expire on December 31, 2006. This LOC agreement was replaced by the credit agreement (See (c) below) on December 30, 2004.

(c) Credit Agreement

On December 30, 2004, the Company entered into a credit agreement with UBS Securities LLC, as lead arranger, and three other financial institutions which matures on December 30, 2009. The credit agreement provides for a revolving line of credit, subject to a borrowing base formula calculated on eligible accounts receivable and eligible scrap metal inventory, of up to \$120,000. Borrowings under the credit agreement bear interest at a rate equal to the base rate (which is based on the UBS AG Bank "prime rate") plus 1.00%, 1.25% or 1.50% depending on the Company's total liquidity (greater than \$50,000, \$25,000 to \$50,000 and less than \$25,000, respectively). Total Liquidity is generally defined per the credit agreement as the sum of the borrowing base availability (determined monthly) and the available cash. The credit agreement will generally be used to issue letters of credit to support financial assurance needs related to our insurance, environmental, bonding and vendor programs. The letters of credit bear an annual fee of 2.0%. As of

PHILIP SERVICES CORPORATION

Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

December 31, 2004, there were no borrowings outstanding (\$27,346 of borrowing base availability) and outstanding letters of credit of \$76,584.

As of December 31, 2004, the Company was required to maintain the following financial covenants under the credit agreement: (i) maximum leverage, which is consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") to consolidated indebtedness, ratio of 5 to 1, (ii) maximum senior leverage, which is consolidated EBITDA to consolidated indebtedness less all subordinated indebtedness, ratio of 3 to 1 and (iii) minimum fixed charge coverage, which is consolidated EBITDA to the sum of consolidated interest expense, capital expenditures, cash tax payments and principal payments, ratio of 1.1 to 1. Financial covenants are not tested if total liquidity is \$25 million or greater. At December 31, 2004, the Company was in compliance with the covenants under the credit agreement.

(d) Payment-In-Kind Promissory Notes

On December 31, 2003, the Company issued an aggregate amount of \$15,291 of unsecured payment-in-kind promissory notes ("PIK promissory notes"). The PIK promissory notes are seven year note obligations that bear interest at an annual fixed rate of 3.6% and have a maturity date of December 31, 2010. On the PIK promissory notes maturity date, the entire \$15,291 of PIK promissory notes principal as well as all PIK promissory notes interest which was accrued over the life of the PIK promissory notes is due in full and is required to be paid to the note holders in cash. At December 31, 2004, there was \$569 of accrued interest on the PIK promissory notes. The \$15,291 PIK promissory notes balance plus accrued interest of \$624 was subsequently paid in full by the Company in February 2005.

(e) The various components of long-term debt described in this note are financial instruments. As of December 31, 2004, the carrying value of the Company's debt approximates its fair market value.

(f) The aggregate amount of payments required to meet long-term debt installments in each of the next five years is as follows:

2005	\$	3,891
2006		2,496
2007		1,744
2008		1,534
2009		106
Thereafter		16,801

(10) Other Liabilities

	DECEMBER 31, 2004
Accrued environmental costs (Note 15)	\$ 41,722
Asset retirement obligation (a)	8,487
Other	42
	<u>\$ 50,251</u>

(a) Asset retirement obligation represents discounted closure and post-closure costs associated with the Company's landfill operations. See Note 15 of the Notes to Consolidated Financial Statements for further discussion.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

(11) Statement of Cash Flows

Changes in assets and liabilities

	FOR THE YEAR ENDED DECEMBER 31, 2004
Accounts receivable	\$ (23,186)
Cash collateral receivable	88,741
Inventory for resale	(11,861)
Other assets	19,817
Accounts payable, accrued liabilities, and other liabilities	(8,390)
Income taxes payable	(2,407)
	<u>\$ 62,714</u>

Supplemental cash flow information

The supplemental cash flow disclosures and non-cash transactions are as follows:

	FOR THE YEAR ENDED DECEMBER 31, 2004
Supplemental Disclosures:	
Interest paid	\$ 7,575
Income taxes paid, net of refunds	531
Reorganization exit costs paid	10,914

(12) Common Stock

	DECEMBER 31, 2004
Share capital consists of-	
Authorized:	
5,000,000 shares of preferred stock	
20,000,000 shares of common stock	
Issued and Outstanding:	
Shares of common stock	10,000,000
Par value per share	\$ 0.01

(13) Income Taxes

The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, the Company provides deferred income taxes for the tax effects of temporary differences between the financial reporting and income tax bases of the Company's assets and liabilities.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

The Company is organized under the laws of the State of Delaware and is regarded as a United States corporation. The Company filed for bankruptcy protection in the United States (Chapter 11) and for CCAA in Canada ("Bankruptcy proceedings") during June 2003 and September 2003, respectively. The Company emerged from Bankruptcy proceedings on December 31, 2003. Distribution of the new common stock of the Company to the Company's creditors pursuant to the 2003 reorganization plan qualified under Section 382 (l) (5) of the Internal Revenue Code, therefore the net operating loss carryforward has no annual limitation.

As of December 31, 2003, the Company had net operating loss carryforwards in the U.S. of \$435,485 (subject to adjustment as described below). The U.S. net operating loss carryforwards expire between the years 2019 and 2022. The Company had \$102,498 in excess interest deductions carryforwards which carry forward indefinitely. At December 31, 2003, the Company recognized cancellation of indebtedness income which reduced the net operating loss carryforward by \$244,942 and reduced the tax basis of assets of certain subsidiaries by \$125,535.

The Company will join the affiliated group of corporations controlled by Mr. Carl C. Icahn in filing a consolidated federal income tax return for the year ended December 31, 2004. The Parent entity of the affiliated group of corporations controlled by Mr. Icahn is named Starfire Holding Corporation ("Starfire"). The Company has entered into a Tax Allocation Agreement with Starfire that provides that while the Company files on a consolidated basis with Starfire, Starfire will pay all consolidated federal income taxes on behalf of the consolidated group which includes the Company. The Company will make payments to Starfire in amount equal to the tax liability, if any, that it would have if it was to file as a consolidated group separate and apart from Starfire.

U.S. and foreign income from continuing operations before taxes are as follows:

	FOR THE YEAR ENDED DECEMBER 31, 2004
U.S.	\$ 66,318
Non U.S.	1,374
Total	<u>\$ 67,692</u>

Federal, state and foreign benefit for income taxes are as follows:

	FOR THE YEAR ENDED DECEMBER 31, 2004
Current - U.S. Federal and state	\$ (842)
Deferred - U.S. Federal and state	21,475
	<u>20,633</u>
Current - Non-U.S.	(2,034)
Deferred - Non-U.S.	2,079
	<u>45</u>
Benefit for income taxes	<u>\$ 20,678</u>

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

The Company's benefit for income taxes comprise the following:

	FOR THE YEAR ENDED DECEMBER 31, 2004
Income tax expense based on statutory effective income tax rates	\$ (23,692)
Decrease in income tax benefit resulting from:	
Tax rate differentials in other jurisdictions	(1,756)
Non-deductible expenses	(661)
Valuation allowance reversal	46,787
Benefit for income taxes	<u>\$ 20,678</u>

The net deferred tax asset consists of the following temporary differences:

	FOR THE YEAR ENDED DECEMBER 31, 2004
Net operating loss and excess interest deduction carryforwards	\$ 90,292
Property, plant and equipment and goodwill basis differences	2,996
Accruals not yet deductible	13,723
Environmental / Insurance reserves	34,150
Inventory	1,648
Other	374
Valuation allowance	(113,532)
Deferred tax asset	<u>\$ 29,651</u>

Upon emergence from the Bankruptcy proceedings, the Company has reassessed the value of the U.S. deferred tax assets. Management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. Projected future income tax planning strategies and the expected reversal of deferred tax liabilities are considered in making this assessment. The Company determined at this time, based on the income of this year, and the level of projections for future taxable income over the periods in which the deferred tax assets are deductible, that it is more likely than not that the Company will realize a portion of the benefits of its U.S. deferred tax assets. Therefore, as of December 31, 2004, the valuation allowance has been reduced to \$113,532 with regard to the U.S. deferred tax assets. The Company will analyze and assess this valuation allowance again as of December 31, 2005. The Company has not provided a valuation allowance against its Canadian deferred tax assets, primarily comprised of property, plant and equipment basis differences, tax basis goodwill resulting from the Canadian restructuring, and environmental reserves not yet deductible, based on consideration of the level of projections of future taxable income over the periods in which the deferred tax assets are deductible.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

(14) Commitments

Future rental payments required under operating leases for premises and equipment are as follows:

2005	\$	7,840
2006		5,475
2007		4,064
2008		3,384
2009		2,463
Thereafter		11,910

Rental expense amounted to \$32,476 for the year ended December 31, 2004. Letters of credit issued by the Company amounted to \$76,584 at December 31, 2004.

(15) Contingencies

(a) The Company is not currently a party to any material pending legal proceedings, other than routine matters incidental to the business, and no material developments have occurred in any such proceedings. The Company is unable to predict the outcome of the foregoing matters and cannot provide assurance that these or future matters will not have a material adverse effect on the results of operations or financial condition of the Company.

(b) The Company (together with the industries in which it operates) is subject to federal, state, local and foreign (particularly Canadian) environmental laws and regulations concerning discharges to the air, soil, surface and subsurface waters and the generation, handling, storage, transportation, treatment and disposal of waste materials and hazardous substances. The Company and the industries in which it operates are also subject to other federal, state, local and foreign (particularly Canadian) laws and regulations including those that require the Company to remove or mitigate the effects of the disposal or release of certain materials at various sites.

It is impossible to predict precisely what effect these laws and regulations will have on the Company in the future. Compliance with environmental laws and regulations may result in, among other things, capital expenditures, costs and liabilities. Management believes, based on past experience and its best assessment of future events, that these environmental liabilities and costs will be assessed and paid over an extended period of time. The Company believes that it will be able to fund such liabilities and costs in the ordinary course of business.

Certain of the Company's facilities are environmentally impaired in part as a result of operating practices at the sites prior to their acquisition by the Company and as a result of Company operations. The Company has established procedures to routinely review and evaluate these sites which require remediation and determine its estimated costs for the likely remedy, giving consideration to the nature and extent of the contamination. There can sometimes be a range of reasonable estimates of the costs associated with the likely remedy of a site. In these cases, the Company uses the amount within the range that constitutes the best estimate. If no amount within the range appears to be a better estimate than any other, the Company establishes a liability based on the amounts that are the low ends of such ranges in accordance with SFAS No. 5, "Accounting for Contingencies", and its interpretations. The Company has provided for the remediation of these sites based upon management's judgment and prior experience. The Company has estimated the liability to remediate these sites to be \$46,753 as of December 31, 2004.

PHILIP SERVICES CORPORATION

Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

Certain subsidiaries of the Company have been named as potentially responsible or liable parties under U.S. federal and state superfund laws in connection with various sites. It is alleged that the Company and its subsidiaries or their predecessors transported waste to the sites, disposed of waste at the sites, or operated the sites in question. The Company has reviewed the nature and extent of the allegations, the number, connection and financial ability of other named and unnamed potentially responsible parties and the nature and estimated cost of the likely remedy. Based on its review, the Company has accrued an estimate of its liability to remediate these sites at \$526 at December 31, 2004, which is included in the total remediation liabilities noted above and in the table below. If it is determined that more expensive remediation approaches are required in the future, the Company could incur additional obligations, which could be material.

(c) The Company's method of accounting for landfill final capping, closure and post-closure is in accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations". The only Company location impacted by SFAS No. 143 is the Company's sole operating landfill located in Hamilton, Ontario. With the exception of the accounting for capitalized and future landfill final capping costs, SFAS No. 143 does not change the basic landfill accounting followed historically by the Company. In general, the Company recognizes expenses associated with both amortization of capitalized costs and future closure and post-closure obligations on a units-of-consumption basis as airspace is consumed over the life of the landfill. This practice is referred to as life-cycle accounting in the waste industry.

Under the SFAS No. 143 rules, costs associated with future final capping activities that occur during the operating life of a landfill are accounted for as an asset retirement obligation, on a discounted basis. Under the SFAS No. 143 rules, the Company records a landfill retirement obligation that relates to its closure and post-closure activities over the operating life of the landfill as the landfill airspace is consumed and the asset retirement obligation is incurred. The Company's asset retirement obligation was determined based on its estimated fair value, which was measured on a present value basis, using a credit-adjusted, risk-free rate of 7.75%, which represents the prime interest rate plus 2%, coupled with an inflation rate of 2.25%. Accretion expense was and will continue to be added to the landfill retirement obligation using the effective interest method. All landfill retirement costs arising from closure and post-closure obligations were capitalized as part of the landfill asset and are being amortized using the Company's existing landfill accounting practices. For the year ended December 31, 2004, accretion expense associated with the asset retirement obligation was \$362, translation adjustments associated with the asset retirement obligation were \$660 and spending against the asset retirement obligation was \$353.

The liabilities discussed above are disclosed in the Consolidated Balance Sheet as follows:

DECEMBER 31, 2004			
	ENVIRONMENTAL		
	REMEDIATION	LANDFILL	TOTAL
Accrued liabilities	\$ 5,031	\$ -	\$ 5,031
Other liabilities	41,722	8,487	50,209
	\$ 46,753	\$ 8,487	\$ 55,240

Estimates of the Company's liability for remediation of a particular site and the method and ultimate cost of remediation require a number of assumptions and are inherently difficult, and the ultimate outcome may differ from current estimates. As additional information becomes available, estimates are adjusted. It is possible that technological, regulatory or enforcement developments, the results of environmental studies or other factors could alter estimates and necessitate the recording of additional liabilities, which could be material. Moreover, because the Company has disposed of waste materials at numerous third-party disposal

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements

December 31, 2004
(Amounts in Thousands)

facilities, it is possible that the Company could be identified as a potentially responsible party at additional sites. The impact of such future events cannot be estimated at the current time.

(16) Related Parties

During most of 2004, the Company's largest stockholder, Carl C. Icahn, participated in the Company's term debt and PIK facilities through entities he controlled. During 2004, the Company repaid in full the \$150,000 term loan provided by Mr. Icahn upon emergence from Chapter 11 bankruptcy on December 31, 2003. Mr. Icahn controlled approximately \$14,316 of the Company's debt as of December 31, 2004 and was associated with approximately \$8,570 in interest expense and fees for the year ending December 31, 2004.

The Company has entered into a Tax Allocation Agreement ("Agreement") with Starfire. The Agreement provides that Starfire will pay all consolidated federal income taxes on behalf of the consolidated group which includes the Company. The Company will make payments to Starfire in an amount equal to the tax liability, if any, that it would have if it was to file as a consolidated group separate and apart from Starfire.

The Company used XO Communications Inc. during 2004 to provide the majority of its telecommunications services. Mr. Icahn owns a majority interest in XO Communications, Inc.

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements
December 31, 2004
(Amounts in Thousands)

(17) Supplemental Financial Information: Consolidating Financial Information

CONSOLIDATING BALANCE SHEET	DECEMBER 31, 2004		
	INDUSTRIAL SERVICES	METALS SERVICES	TOTAL
ASSETS			
Current assets			
Cash and cash equivalents (Note 2)	\$ 35,156	\$ 24,566	\$ 59,722
Accounts receivable (net of allowance for doubtful accounts) (Note 4)	80,818	68,798	149,616
Inventory	-	53,915	53,915
Other current assets (Note 5)	22,627	4,677	27,304
Total current assets	138,601	151,956	290,557
Property, plant and equipment (Note 6)	121,723	54,670	176,393
Deferred income taxes (Note 13)	12,498	17,153	29,651
Other assets (Note 7)	44,835	3,506	48,341
Total assets	\$ 317,657	\$ 227,285	\$ 544,942
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	\$ 18,901	\$ 17,421	\$ 36,322
Accrued liabilities (Note 8)	72,979	12,978	85,957
Current maturities of long-term debt (Note 9)	2,688	1,203	3,891
Total current liabilities	94,568	31,602	126,170
Long-term debt, less current portion (Note 9)	12,050	10,631	22,681
Other liabilities (Note 10)	30,293	19,958	50,251
Commitments and contingencies (Note 14 and 15)			
Stockholders' equity	180,746	165,094	345,840
Total liabilities and stockholders' equity	\$ 317,657	\$ 227,285	\$ 544,942

PHILIP SERVICES CORPORATION
Notes to Consolidated Financial Statements
December 31, 2004
(Amounts in Thousands)

CONSOLIDATING STATEMENT OF EARNINGS	YEAR ENDED DECEMBER 31, 2004		
	INDUSTRIAL SERVICES	METALS SERVICES	TOTAL
Revenue	\$ 487,791	\$ 660,172	\$ 1,147,963
Operating expenses	399,037	561,082	960,119
Selling, general and administrative costs	62,705	18,059	80,764
Depreciation and amortization	26,044	8,394	34,438
Income from operations	5	72,637	72,642
Interest expense	10,015	2,405	12,420
Other income, net	587	6,883	7,470
Income (loss) from continuing operations before income taxes	(9,423)	77,115	67,692
Benefit for income taxes (Note 13)	4,875	15,803	20,678
Income (loss) from continuing operations	(4,548)	92,918	88,370
Income from discontinued operations, net of taxes (Note 3)	2,740	-	2,740
Net income (loss)	\$ (1,808)	\$ 92,918	\$ 91,110